Effective Date: September 19, 1997

COORDINATED ISSUE
UTILITIES INDUSTRY
DEPARTMENT OF ENERGY DECONTAMINATION AND DECOMMISSIONING FUND

SUMMARY:

This paper addresses the treatment of certain assessments imposed on the utility industry by the Energy Policy Act of 1992, Public Law 102–486 ("EPACT" or "Act"), enacted on October 24, 1992. In particular, the Act requires utilities to pay 15 annual Department of Energy ("DOE") special assessments to be contributed to the Uranium Enrichment Decontamination and Decommissioning Fund ("D&D Fund"). The D&D Fund will be used to pay for future decontamination, decommissioning, reclamation and other remedial activities at the DOE's gaseous diffusion uranium enrichment facilities, and for reimbursement of certain similar costs incurred by licensees at active uranium and thorium processing sites.

Many utilities filed or amended their 1992 returns reflecting an increase to their basis in nuclear fuel by an amount representing their total liabilities for the 15 annual special assessments. We shall refer to this method as the "capitalization method." This yields an immediate deduction in 1992 for up to 15 years worth of future payments (if their fuel has already been fully depreciated). In addition, these utilities also take the position that they are entitled to additional investment tax credit ("ITC") based on the increased basis in such nuclear fuel where that fuel originally was eligible for ITC.

This coordinated issue paper rejects the positions advocated by the utilities and concludes that the liabilities for the special assessments represent so-called "payment liabilities" (within the meaning of Treas. Reg. § 1.461-4(g)) that may only be taken into account when paid in accordance with the economic performance regulations under I.R.C. § 461. This method shall be referred to as the "economic performance method."

ISSUES:

1. Whether the liabilities for the special assessments should be deducted only as the annual assessments are paid in 1993 and subsequent years, pursuant to the economic performance rules contained in I.R.C. § 461 and the regulations thereunder (the economic performance method).

2. Whether, instead, the total amount of the 15 annual assessments can be capitalized (upon the enactment of EPACT in 1992) into the basis of old nuclear fuel, thus creating additional 1992 depreciation and investment tax credit (the capitalization method).

3. Whether a utility's attempt to capitalize the total amount of the 15 annual assessments through the filing of an amended return represents an unauthorized change in a method of accounting.

CONCLUSIONS:

1. The liabilities for the special assessments should be deducted only as the annual assessments are paid in 1993 and subsequent years, pursuant to the economic performance method.

2. The total amount of the 15 annual assessments cannot be capitalized (upon the enactment of EPACT in 1992) into the basis of old nuclear fuel or create additional 1992 depreciation or investment tax credit.

3. A utility's attempt to capitalize the total amount of the 15 annual assessments through the filing of an amended return represents an unauthorized change in a method of accounting.

STATEMENT OF FACTS:

This paper addresses the treatment of certain assessments imposed on the utility industry by the Act. The factual background of this issue is explained below by first examining the Act. This is followed by an analysis of the trial and appellate court decisions in **Yankee Atomic Electric Company v. United States**. Finally, the law is examined and applied to the facts.

The Energy Policy Act of 1992 -- Legislative History

The Act provides a funding method for the decontamination and decommissioning of certain uranium processing facilities owned by the DOE. These facilities previously supplied enriched uranium to various users including the Department of Defense, foreign purchasers, and utilities operating nuclear electric generating facilities.[1]

The Energy Policy Act of 1992 -- Statutory Structure

The Act (Title IX) amends the Atomic Energy Act of 1954 by, among other things, adding Sections 1801 and 1802 to the Atomic Energy Act. Section 1801 establishes the D&D Fund. Section 1802(a) provides that the D&D Fund will be financed through

[1]H.R. Rep. No. 474, 102d Cong., 2d Sess., Pt. 1, at 206-207 (1992).

deposits in the amount of $480 million per fiscal year (adjusted annually for inflation). Section 1802(b) establishes two sources for deposits to the D&D Fund: (1) the special assessment on domestic utilities described in section 1802(c); and (2) appropriations as are necessary to ensure that deposits to the fund equal $480 million per fiscal year (adjusted annually for inflation). Section 1802(e) provides that the collection of special assessments by the DOE shall cease at the earlier of 15 years from the date of enactment of this title (October 24, 2007), or when $2.25 billion (adjusted annually for inflation) has been collected.

Section 1802(c) of the Atomic Energy Act requires the DOE to collect the special assessments from domestic utilities. The total amount collected for each fiscal year shall not exceed $150 million (to be annually adjusted for inflation). The amount collected from any particular utility is based on the ratio of (1) separative work units (SWU)[2] purchased by such utility for the purpose of commercial electricity generation prior to October 24, 1992 to (2) the total amount of separative work units purchased from the DOE for all purposes prior to October 24, 1992.

DOE regulations clarify the calculation of the amount each utility owes as a special assessment.[3] The regulations provide the procedures and methods for calculating the amount to be paid into the D&D Fund by domestic utilities. They address substantive matters left by the Act to DOE discretion, such as a required method of payment, late payment fees, and administrative appeals. The regulations also provide procedures for reconciliation and adjustment to DOE invoices.

The methodology for calculating the special assessments provided by the DOE regulations is largely interpretive of the formula in the Act and is described in the attached Exhibit A. However, the regulations clarify several important aspects of the calculation. First, the calculation of the special assessment is made only on the basis of certain commercial purchases -- not all sales are taken into account.[4] Second, it is possible for a utility that never dealt with DOE to be required to pay the assessments if it purchased fuel from another utility.[5]

Section 1802(g) of the Atomic Energy Act provides that the special assessments levied on domestic utilities shall be deemed a necessary and reasonable current cost of fuel

---

[2]A separative work unit is a measurement of energy and is the unit by which uranium enrichment services are sold.

[3]10 C.F.R. Part 766.

[4]10 C.F.R. § 766.102.

[5]10 C.F.R. § 766.101.

and shall be fully recoverable in rates in all jurisdictions in the same manner as the utility's other fuel costs. FERC regulations clarify that the special assessments are deemed to be a necessary and reasonable current cost of fuel and are recovered through rate adjustments.[6] Utilities can recover the assessments via fuel cost adjustments and may remain liable even if they no longer engage in nuclear operations.

FERC further clarified the regulatory accounting treatment of the special assessments in a notice issued in 1993. The notice requires that the entire liability for special assessments be reflected as a long–term liability in financial statements currently. The notice indicates that the total obligation for special assessments is not contingent upon future operations. Payments must continue even if a domestic utility no longer operates a nuclear power plant. The notice further states that "each utility's liability for special assessments is sufficiently known and measurable to be recognized in current financial statements."[7]

Subsequent Developments

On July 15, 1993, the independent auditing firm engaged by the DOE to identify the total SWUs delivered from the DOE enrichment facilities and those delivered to each domestic utility customer, submitted its report. The initial bills sent by the DOE (as described hereafter) were based on the results of this audit report.

In August 1993, the DOE sent a letter to utilities in which it set forth the number of SWUs that DOE records indicated each utility had purchased from DOE prior to enactment of the Act, the number of SWUs delivered by DOE to all domestic utilities, the percentage relationship between the two foregoing numbers, and the estimated amount of each utility's annual assessment. Invoices for the first special assessment were mailed to utilities in September 1993.

Yankee Atomic

The validity of the Act was challenged in the United States Court of Federal Claims in **Yankee Atomic Electric Company v. United States**, 33 Fed. Cl. 580 (1995). Yankee Atomic Electric Company, the utility, asserted two theories of recovery which are relevant to this issue: 1) that the special assessment is a breach of contract, in that it retroactively increases the costs of the Government's uranium enrichment services,

---

[6]18 C.F.R. § 35.28.

[7]58 Fed. Reg. 36,193 (1993).

thereby violating the "fixed-price" character of the contracts under which those services initially were obtained; and 2) that the special assessment constitutes the deprivation of a contract-based advantage and hence, the taking of a property right under the Fifth Amendment of the U.S. Constitution. In contrast, the United States argued that the special assessment does not violate the Fifth Amendment. In taking this position, the Government characterized the special assessment as a tax.

The trial court held that the special assessment is an unlawful exaction because it violates the Government's earlier commitments to supply enriched uranium at contract prices not to exceed a stated amount and thus improperly diminishes the value of property that Yankee Atomic acquired pursuant to those commitments. In reaching this conclusion, the trial court dismissed the Government's contention that the special assessment is a tax.

On appeal, the United States Court of Appeals for the Federal Circuit reversed the opinion of the Court of Federal Claims and upheld the validity of the special assessments. The Federal Circuit likened the special assessments to taxes and held that the sovereign power to tax could not be limited because the contracts between Yankee and the government did not "unmistakably preclude" the government from subsequently exercising its sovereign power to tax. The Federal Circuit refused to accept Yankee's argument that the special assessments represent retroactive price adjustments. In reaching this conclusion, the Federal Circuit attached significant weight to the fact that the special assessments were not levied only against utilities in contractual privity with the government, but against all ultimate users.

LAW & ANALYSIS:

It is the Service's position that liabilities for the special assessments are incurred when paid under Section 461(h) of the Code. Further, special assessments do not increase the basis of nuclear fuel and do not give rise to additional depreciation or investment tax credit. These issues are analyzed below.

I. Timing Under § 461

Section 461(a) of the Code provides generally that the amount of any deduction or credit shall be accounted for in the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 461(h)(1) of the Code provides generally that in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance

with respect to such item occurs. Section 461(h)(4) further provides that the all events test is met with respect to any item if all events have occurred which determine the fact of the liability and the amount of such liability can be determined with reasonable accuracy. See § 1.461–1(a)(2)(i).

Section 461(h)(2) of the Code provides rules for determining when economic performance occurs. See also § 1.461–4(d). Under these rules, the time when economic performance occurs depends on the type of liability. If the liability arises out of the provision of services to the taxpayer by another person, economic performance occurs as such person provides such services. § 461(h)(2)(A)(i); § 1.461–4(d)(2). Similarly, if the liability arises out of the providing of property to the taxpayer by another person, economic performance occurs as the person provides such property. § 461(h)(2)(A)(ii); § 1.461–4(d)(2). Finally, if the liability arises out of the use of property by the taxpayer, economic performance occurs as the taxpayer uses such property. § 461(h)(2)(A)(iii); § 1.461–4(d)(3). Sections 461(h)(2)(B) and (C) also provide general rules for determining the time when economic performance occurs where (1) taxpayers provide services or property, and (2) the liability arises under any workers compensation act or any tort. For any other type of liability, § 461(h)(2)(D) provides that economic performance occurs at the time determined under regulations.

Section 1.461–4(g) of the Regulations provides guidance for certain liabilities for which payment is economic performance. These liabilities are referred to as "payment liabilities." Under § 1.461–(4)(g)(6), if the liability of a taxpayer is to pay a tax, economic performance occurs as the tax is paid to the governmental authority that imposed the tax. The regulation further provides that for purposes of paragraph (g)(6), a tax does not include a charge collected by a governmental authority for specific extraordinary services or property provided to a taxpayer by the governmental authority. Further, in the case of a liability for which specific economic performance rules are not provided, economic performance occurs as payment is made to the person to whom the liability is owed under § 1.461–4(g)(7). These types of liabilities are hereinafter referred to as "other payment liabilities."

A. The All–Events Test

As noted above, § 461(h)(4) of the Code provides that the all–events test is met if all events have occurred which determine the fact of liability and the amount of such liability can be determined with reasonable accuracy. Utilities generally will be able to satisfy these tests as of the date the Act was passed for the reasons described below.

1. Fact of Liability

The fact of liability must be established before an expense is deductible under § 1.461–1(a)(2). DOE is required to collect the special assessments from domestic utilities under section 1802 of the Act. This statutory requirement fixes the utilities' obligation to pay the special assessments for purposes of § 461. See **United States v. Hughes Properties, Inc.**, 476 U.S. 593 (1986) (state gaming commission regulations fixed casino's liability for progressive slot machine jackpot); **Ohio River Collieries Co. v. Commissioner**, 77 T.C. 1369 (1981) (state law requiring taxpayer to restore land after strip mining fixed taxpayer's liability under § 461). Accordingly, passage of the Act in 1992 fixed the fact of liability for the special assessments.

2. Reasonable Accuracy

In determining when a liability is incurred, it is not necessary that the amount of the liability be fixed with absolute certainty. Indeed, § 461(h) of the Code requires only that the amount of the liability can be determined with reasonable accuracy. The fact that the exact amount of the liability cannot be determined does not prevent a taxpayer from taking into account that portion which can be computed with reasonable accuracy under § 1.461–1(a)(2)(ii) of the Regulations. Utilities were able to compute the amount of their liability for special assessments with reasonable accuracy under this standard in 1992 when the Act was passed.

Under the Act, each utility is required to pay an allocable share of up to $150 million per year through the year 2007 or until $2.25 billion has been collected. The methodology for allocating the special assessments among utilities is set forth in the Act itself and is based on the ratio of SWUs purchased by a utility to the total SWUs purchased by the entire industry. See § 1802(c) of the Act. Indeed, the legislative history to the Act indicates that the total assessment of each utility is based on the amount of SWUs purchased in the past by that domestic utility compared to the aggregate of all separative work units. H.R. Rep. No. 474, 102d Cong., 2d Sess., pt. 6, at 27 (1992). Utilities had the ability and knowledge to make a reasonable calculation of their liability for special assessments when the Act was passed as they knew not only the amount of SWUs they had purchased but also the amount purchased by the entire industry.[8] Accordingly, in 1992 the amount of the liability for special assessments was reasonably determinable within the meaning of § 461 of the Code.

[8]The ease with which this calculation could be made is demonstrated by a memorandum prepared by the Edison Electric Institute for its members on October 9, 1992. A chart attached to that memorandum estimates each utility's liability for special assessments.

B. Economic Performance

Even though the liabilities for the special assessments were fixed and reasonably determinable in 1992, the special assessments cannot be treated by the utilities as incurred in 1992 under section 461 due to the lack of "economic performance." Section 461(h) provides that the all events test shall not be treated as met with respect to any item earlier than when economic performance with respect to such item occurs.

1. Payment Liabilities (IRS Primary Argument)

Economic performance with respect to the instant special assessments did not occur in 1992 because the liabilities for the special assessments constitute so-called "payment liabilities." Payment liabilities are liabilities for which actual payment is the only means of satisfying the economic performance test. The different types of liabilities which, by regulation, have been classified as payment liabilities are listed and discussed at Treas. Reg. § 1.461-4(g).

The liabilities for the instant special assessments constitute "payment liabilities" because they represent other (payment) liabilities within the meaning of Treas. Reg. § 1.461-4(g)(7). Although it is arguable that the liabilities for the special assessments represent liabilities for taxes (which are also payment liabilities under Treas. Reg. § 1.461-4(g)(6)), this argument should not be advanced, as explained below.

a. Tax Liabilities

Although the Federal Circuit in Yankee Atomic found the special assessments akin to taxes, the Service will not, at this time, advance this position for the purpose of using Treas. Reg. § 1.461-4(g)(6) to argue that the special assessments represent tax liabilities, and hence, payment liabilities.

b. Other Liabilities

Treas. Reg. § 1.461–4(g)(7) provides that, in the case of liabilities for which there is no specific guidance, economic performance occurs as payments are made in satisfaction of those liabilities. The liabilities for the special assessments represent liabilities for which there is no specific guidance. Accordingly, economic performance occurs only as the special assessments are paid.

2. Liability for Future Services (IRS Alternative Argument)

If the special assessments are not regarded as payment liabilities under § 1.461–4(g)(6) or (7) of the Regulations, the Service's alternative position is that the special assessments are service liabilities related to the future services of cleaning up the processing facilities, a part of the performance of uranium enrichment services to utilities. Support for this view is found in the Act's legislative history which refers to the existing statutory requirement that DOE recover its costs of the uranium enrichment program.[9] The legislative history to the Act indicates that special assessments are a way of complying with this legal requirement. H.R. Rep. No. 474, 102d Cong., 2d Sess., pt. 8, at 77–78 (1992). By treating the costs of cleaning up the processing facilities as part of the cost of the uranium enrichment program the legislative history demonstrates that cleanup is part of the process of providing enriched uranium to utilities. The special assessments are intended to cover the costs of the cleanup services, which were not performed in 1992 and, therefore, the economic performance requirement of § 461(h) was not satisfied in 1992. As stated, for a liability arising out of the provision of services to the taxpayer, economic performance occurs as the services are provided. § 1.461-4(d)(2).

3. Not Liabilities for Prior Services (Utilities' Argument Distinguished)

Utilities argue that the special assessments do not fall within the other liability provision because the liability arises out of the providing of prior services to the taxpayer, namely, the uranium enrichment services that DOE provided to the utilities before enactment of the Act. The Service disagrees. I.R.C. § 461(h)(2)(A)(i) provides that if the liability of the taxpayer arises out of the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services. The liabilities for the special assessments arose from the enactment of the Act, not from the provision of prior services to the taxpayer. Ownership of previously enriched uranium merely serves as a method to apportion the liabilities among domestic utilities who are liable for the special assessments. Moreover, special assessments can be levied even if a utility received no enrichment services from the DOE (e.g., by purchasing all enriched uranium on the open market).

When utilities contracted for the prior enrichment services, nothing in the contracts referred to the decontamination and decommissioning of uranium enrichment facilities. Utilities were not obligated to pay for D&D costs, nor were the utilities bound to pay for additional costs not set forth in the contracts. Clearly, the special assessment liabilities did not arise from the providing of prior services because no intent existed to bind the utilities into paying for the special assessments when the services were provided, nor did the parties intend to bind the utilities into paying for the D&D costs when the

---

[9]DOE was required to recover its cost of processing uranium over a reasonable period of time. See 42 USC § 2201.

contracts were entered into. The contracts binding the utilities to pay for enrichment services did not refer to D&D costs. No other relevant contracts were entered into between the parties. The absence of any obligation to pay for the cleanup costs in the contracts indicates that the subject liability did not arise from the providing of prior enrichment services.

II. Clear Reflection of Income

Treas. Reg. § 1.446-1(a)(2) provides that no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. See also section 446(b).

Case law that supports this general proposition includes **Thor Power Tool Co. v. Commissioner**, 439 U.S. 522, 532 (1979) ("on their face §§ 446 and 471, with their accompanying regulations, vest the Commissioner with wide discretion in determining whether a particular method of inventory accounting should be disallowed as not clearly reflective of income"); **U.S. v. Catto**, 384 U.S. 102, 114 and n.22, reh'g denied, 384 U.S. 981 (1966) ("Congress has granted the Commissioner broad discretion in shepherding the accounting methods used by taxpayers"); **Commissioner. v. Hansen**, 360 U.S. 446, 467 and n.12 (1959) ("The Commissioner has broad powers in determining whether accounting methods used by a taxpayer clearly reflect income"); **Lucas v. Kansas City Structural Steel Co**., 281 U.S. 264, 271 (1930) (taxpayer must show Service's action "plainly arbitrary").

Under the Act, the special assessments levied on domestic utilities were deemed a necessary and reasonable current cost of fuel, fully recoverable in rates in all jurisdictions in the same manner as other fuel costs. As a result of being classified as a current cost of fuel, state regulatory authorities allow utilities to recover this cost from their ratepayers. If the special assessments were viewed as a retroactive price adjustment, utilities most likely would not have been able to recover this cost from their ratepayers because it could be viewed as retroactive rate making which is typically prohibited. By deeming the special assessments as a current cost of fuel, Congress insured that domestic utilities remained whole by being permitted to pass the special assessment costs on to their ratepayers as the special assessments were paid.

Pursuant to a regulatory accounting mandate issued by the Federal Energy Regulatory Commission, the liabilities for payment of the special assessments are to be reflected on the balance sheet as current and non–current debt, with the current costs of satisfying the liability charged to fuel costs and the remainder deferred. Specific procedures were established to limit the recovery of costs through rates for any

particular year to the amount paid to the DOE.[10]

Section 446(a) of the Code and Regulation § 1.446–1(a)(1) provide that taxable income is computed using the method that the taxpayer regularly uses to compute its income in keeping its books. Section 1.446–1(a)(2) provides that a method of accounting under which the taxpayer has consistently applied GAAP in accordance with the accepted practices in a trade or business will ordinarily be regarded as clearly reflecting income. Where a taxpayer's generally accepted method of accounting is made compulsory by a regulatory agency and that method clearly reflects income, it is almost presumptively controlling of Federal income tax consequences (**Commissioner v. Idaho Power Co.**, 418 U.S. 1 (1974), 1974–2 C.B. 85).

The Service's position is that the method of accounting for the special assessments required by the Federal Energy Regulatory Commission for computing book income clearly reflects income. Therefore, this method should control for computing federal taxable income. This method would allow a utility a deduction for federal tax purposes only as the annual payments are made, which is consistent with how the liability is treated for computing book income.

The industry's attempt to accrue, in the taxable year 1992, special assessments payable over the next fifteen years would also create a substantial distortion of income. This situation is similar to **Ford Motor Co. v. Commissioner**, 102 T.C. 87. (1994), aff'd, 71 F.3d 209 (6th Cir 1995). In **Ford**, the company entered into various settlements with tort claimants. Ford was obligated, under the terms of the settlement agreements, to make a series of payments to each of the tort claimants over various periods, the longest of which was 58 years. Ford, an accrual basis taxpayer, claimed a deduction in 1980 for the full amount of all future payments it was obligated to make under the terms of the settlement agreements it executed during 1980. The Tax Court in **Ford** applied section 446 of the Internal Revenue Code in determining that the significant length of time for the pay out caused a distortion of income. In the present case, if a utility is permitted to accrue all special assessments, payable over fifteen years, in 1992, it would create a substantial distortion of income.

The Service contends that the utilities' method of accounting for the special assessments adopted for computing book income (pursuant to FERC requirements) most clearly reflects income, and there is no basis for deviation from this method in computing taxable income. Treating the special assessments as payment liabilities for federal tax return purposes provides symmetry between book and tax

---

[10]This means that for book (and regulatory) purposes a utility is only authorized to expense the special assessments that are to be paid currently. Those special assessments that are to be paid in future years are deferred and treated as non-current debt.

income, and results in a clear reflection of income. Finally, the book method for the special assessments made compulsory by FERC (which mirrors the accounting method recommended by the Service) is almost presumptively controlling of Federal income tax consequences. See **Idaho Power** supra.

III. Basis Adjustment and ITC

Section 167 of the Internal Revenue Code allows for a depreciation deduction for property used in a trade or business or held for the production of income. Section 168 of the Code provides for the Modified Accelerated Cost Recovery System of depreciation which allows for accelerated rates of depreciation.

Sections 46 and 48 of the Internal Revenue Code had previously allowed for Investment Tax Credit on nuclear fuel prior to January 1, 1986.

The Tax Reform Act of 1986 repealed the regular investment tax credit for property placed in service after 1985. Property may qualify as transition property if (1) it falls within a specific effective date category, (2) it is placed in service by a specified date depending on its class life, and (3) it is specifically described in the transition rules.

As discussed above, the utilities have, for 1992, attempted to capitalize the cumulative amount of the 15 annual special assessments into the basis of old nuclear fuel. Because this old nuclear fuel has already been depreciated to a large extent, the utilities have attempted to claim large 1992 depreciation deductions. Also, the utilities have attempted to claim 1992 investment tax credits as well.

The utilities are not entitled to treat the special assessments in this manner. Instead, as discussed in detail above, the liabilities for the special assessments should be treated as "other payment liabilities" within the meaning of Treas. Reg. § 1.461-4(g)(7). As these liabilities are paid, the utilities are entitled to fuel cost business deductions under section 162.

INDUSTRY'S ARGUMENTS:

Utilities advance a number of arguments in favor of treating special assessments as a liability arising from the providing of prior services. These arguments are examined and rejected below.

1) The method by which the amount of special assessments is calculated supports treating special assessments as arising from the provision of services, namely, as price adjustments for the prior services. The calculation of the utilities'

liability is made on the basis of prior fuel purchases. See 10 C.F.R. Part 766. Utilities assert that this shows that the special assessments are nothing more than retroactive price adjustments.

Rebuttal:

First, the liabilities for special assessments arise from the passage of the Act. The apportionment formula is nothing more than a methodology to allocate the amount of the special assessments to be collected from each domestic utility pursuant to the Act. The fact that the special assessments are determined by a formula that uses prior enrichment services does not lead to a conclusion that the liability arises from the provision of those services. Absent the Act, the special assessment liability, which is apportioned to domestic utilities based on prior services, would never have arisen.

Second, DOE's regulations are inconsistent with treating special assessments as price adjustments. In particular, the calculation of the special assessments is made only on the basis of certain commercial purchases -- not all sales are taken into account. More importantly, it is possible for a utility that never dealt with DOE to be required to pay the assessment if it purchased fuel from another utility. The Appeals court in **Yankee Atomic** expressly rejected the argument that the special assessments represent retroactive price adjustments. The Court attached significant weight to the fact that the special assessments were not levied only against utilities in contractual privity with the government, but against all ultimate users.

2) A second argument advanced by utilities to support treating special assessments as price adjustments is based on the Act's legislative history. In particular, the legislative history refers to the existing statutory requirement that DOE recover its costs of the uranium enrichment program. The legislative history to the Act indicates that special assessments are a way of complying with this legal requirement. H.R. Rep. No. 474, 102d Cong., 2d Sess., pt. 8, at 77–78 (1992). Utilities assert that this shows that special assessments are nothing more than retroactive price adjustments.

Rebuttal:

As stated previously, the liability for special assessments arises from the passage of the Act. Even if the special assessments are a way for DOE to recover its costs of the uranium enrichment services, it does not mean that the special assessments arise from the provision of prior services.

3) A third argument advanced by utilities is that special assessments must relate to prior sales as DOE no longer provides enrichment services. Therefore, the assessment cannot be a current cost of services and must be a price adjustment for prior purchases. The utilities further reason that section 1802(g) of the Act was included only to address a possible ratemaking argument. In addition, the utilities assert that special assessments are retroactive price adjustments because the assessments relate only to the clean–up of prior contamination and not to new contamination.

Rebuttal:

As stated above, the liabilities for special assessments arise from the passage of the Act. The apportionment formula is nothing more than a methodology to allocate the amount of the special assessments to be collected from each domestic utility pursuant to the Act. Accordingly, the fact that DOE no longer provides enrichment services to the Utilities or that DOE was attempting to collect a portion of its "prior contamination" costs is irrelevant.

Section 1802(g) of the Act states that the special assessments shall be deemed a necessary and reasonable current cost of fuel. See 18 C.F.R. § 35.2. Treating special assessments as a current operating cost is inconsistent with the position that the assessments are price adjustments for previously purchased fuel.

Lastly, as noted above, even if the special assessments relate to enrichment services, the services have not been completed -- the cleanup remains to be performed. Accordingly, economic performance has yet to occur under § 461(h)(2)(A)(i).

IV. Unauthorized Change In Method Of Accounting

A. Adoption of Method

Before a change in an accounting method for an item can be regarded as unauthorized, it must first be shown that the taxpayer has adopted a method of accounting with respect to that item.

Generally speaking, according to the regulations, a taxpayer filing his first return may adopt any permissible method of accounting in computing taxable income with respect to each separate and distinct trade or business. Treas. Reg. § 1.446-1(e)(1). A method of accounting includes, not only an overall method, but also a method of

accounting for a material item. Treas. Reg. § 1.446-1(e)(2)(ii)(a). A material item includes any item which involves the proper time for the taking of a deduction. Id.

Based upon the above, it is clear that the utilities' treatment of the special assessments involves a method of accounting. Less clear is how and at what point the utilities will be deemed to have adopted their accounting method for the special assessments.

We believe that the utilities adopted their method of accounting for the special assessments with the filing of their 1992 original returns by virtue of deciding in their 1992 original returns to defer their deductions until actual payment in future years. See Alkire, Tax Accounting, section 2.04 (Matthew Bender 1996) (a detailed method of accounting for a particular item of income or deduction may generally be adopted on the return for the first year this item may be present, i.e., 1992 in the instant case). Since deferring the deductions in this case was a proper method of accounting for the special assessments, it would be regarded as adopted for 1992 without the necessity of a "consistent use" over a two year period. Rev. Rul. 90-38, 1990-1 C.B. 57. Although we believe that no "consistent use" requirement exists in this circumstance, it is important to note that "consistent use" can be established in the following year if the economic performance method was, in fact, used in the utilities' 1993 returns, where deductions were taken upon actual payment. This second year use provides the Service with additional support for its argument regarding the 1992 year of adoption.

It is theoretically sound to treat 1992 as the year of adoption even though no formal election was required and no amounts with respect to the special assessments appeared on the 1992 returns.[11] If the utilities had originally adopted their capitalization method for 1992, this would have affected their 1992 returns. Filing the 1992 return without capitalizing these amounts reflects the appropriate deferral of the deductions under the economic performance method. A utility's deferral of deductions in 1992 combined with a 1993 claim of a deduction, would suggest that the utility adopted the economic performance method in 1992. Compare Convergent Technologies, Inc. v. Commissioner, T.C. Memo. 1995-320 [third year adoption of method of accounting by amended return was approved because it represented the correction of an error on third year original return and method adopted was not inconsistent with the proper omission of the item in first two years before transaction came to fruition].

---

[11]Although no deduction may appear on the 1992 tax return, a utility may have made book entries pursuant to FERC requirements relating to the special assessments. As stated earlier, the liabilities for payment of the special assessments are to be reflected on the balance sheet as current and non-current debt. A utility's balance sheet should be reviewed to see if such an account has been established in 1992.

B. Change in Accounting Method

Once established that a utility has adopted an accounting method for their special assessments, it is clear that this method cannot be changed without the Commissioner's prior consent. I.R.C. § 446(e). Treas. Reg. § 1.446-1(e)(3)(i) provides that, in order to secure the Commissioner's consent to change a method of accounting, the taxpayer must file an application on Form 3115 if the taxpayer desires to make the change. If a utility did not satisfy this administrative requirement, it should not be able to change its method of accounting for the special assessments adopted in 1992. This is true even assuming, arguendo, that the utility is attempting to change from an erroneous method to a permissible method by filing amended returns, and even if the period for amending the return for the first year in which the erroneous method was used has not expired. See Rev. Rul. 90-38, supra.

EXHIBIT A

The amount of the Special Assessment for any specific utility is calculated using the following steps:

1) Calculate Special Assessment Ratio:

SWUs purchased by all domestic utilities (as of 10/24/92)
———————————————————————————
Total SWUs produced -- all purposes (as of 10/24/92)

2) Calculate the Baseline Total Annual Special Assessment:

Special Assessment Ratio * $480 million (cap at $150 million)

3) Calculate Special Assessment Ratio per Utility:

Single Utility's SWUs (as of 10/24/92)
———————————————————————————
SWUs purchased by all domestic utilities (as of 10/24/92)

4) Calculate Individual Utility Assessment:

Line (2) above * Line (3) above

5) Calculate Inflation Adjustment Multiplier:

CPI–U as of billing date
———————————————————
CPI–U as of October 1992 (141.8)

6) Calculate Adjusted Utility Special Assessment:

Line (4) above * Line (5) above